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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

STATUTORY REVIEW OF THE SYSTEM FOR REGULATING RATES AND CLASSES FOR MARKET DOMINANT PRODUCTS	)))	Docket No. RM2017-3

COMMENTS OF THE AMERICAN FOREST & PAPER ASSOCIATION

Pursuant to Order No. 3673, the American Forest & Paper Association ("AF&PA") respectfully submits these comments in response to the Commission's notice of proposed rulemaking ("NOPR") that would implement a new regulatory system that would operate for the next five years and is the result of the Commission's 10 year review of the system for regulating rates and classes for market dominant products. For the reasons outlined below, AF&PA requests that the Postal Regulatory Commission ("PRC" or "Commission") reconsider its proposed solution to the financial challenges facing the U.S. Postal Service ("USPS" or "Postal Service). AF&PA believes the USPS can realize success under the current system and meet the needs of the mailing industry, including the paper products companies that supply the raw materials for print communications and packages carried in the mail.

I. American Forest & Paper Association and the Postal Industry

AF&PA serves to advance a sustainable U.S. pulp, paper, packaging, tissue and wood products manufacturing industry through fact-based public policy and marketplace advocacy. AF&PA member companies make products essential for everyday life from renewable and recyclable resources and are committed to continuous improvement through the industry's sustainability initiative - *Better Practices, Better Planet 2020*. The forest products industry accounts for approximately four percent of the total U.S. manufacturing GDP, manufactures over $200 billion in products annually, and employs approximately 900,000 men and women. The industry meets a payroll of approximately $50 billion annually and is among the top 10 manufacturing sector employers in 45 states.

Our members and our customers depend heavily on getting our products and messages delivered to the final destination in a secure, timely and cost effective manner. Approximately 39 percent, or nearly $6.5 billion, of the communications papers manufactured by the industry are delivered through the mail system. The success of the Postal Service and the mailing industry is therefore vitally important to the success of the paper industry.

II. Summary

AF&PA agrees with the Commission's finding that the current system is a much improved rate making environment than existed before the Postal Accountability and Enhancement Act ("PAEA"), which was time consuming, costly, produced large and unpredictable price increases and created volatile postal financial results. While not perfect, PAEA provided mail customers with a more transparent, stable and predictable rate structure that enabled mailers and supply chain participants to forecast costs and plan ahead.

AF&PA recognizes that the PRC was given the complex task of measuring the effectiveness of the system against multiple, and sometimes conflicting objectives. We agree that the financial stability of the USPS was a keystone objective of Congress when PAEA was crafted, but in our opinion the PRC proposal puts too much weight on this one objective to the detriment of the other PAEA objectives. The paper industry knows all too well that, in an environment where market demand is under pressure, attempting to price oneself out of the challenge is not a viable solution.

AF&PA urges the Commission to reconsider its proposed solution for the financial challenges faced by the USPS. We believe the imposition of postal rates much higher than the rate of inflation will likely further imperil the financial position of the Postal Service by driving away the most valuable and profitable segments of mail. The Postal Service and the Commission must recognize that raising prices is not a successful strategy to address declining demand. We believe that the Commission's proposal will drive a great deal more volume and revenue out of the system, imperiling businesses, jobs, and the Service itself.

III. Argument

A. Rate Making System

The NOPR comes at a time when the Postal Service is fighting to retain business. Prior years of operations in or near the black under the stability of the rate cap raised industry's confidence level that the Postal Service, working within the Consumer Price Index ("CPI") cap, could remain a cost competitive service provider, even with some diversion of mail. PAEA, and the system of regulating rates the Commission established pursuant to the statute, was a significant improvement over the pre-existing system of cost of service regulation. Yet the Postal Service is now seeking to significantly change this innovation for the worse.

AF&PA agrees with the PRC that the current rate-setting system is achieving the objectives and factors of PAEA and the system has worked as intended to create rate adjustments that are stable and predictable with regard to both timing and magnitude. The value of the predictability and stability in rates afforded by the CPI-based price cap cannot be overstated. Predictability of rates is extremely important for ratepayers as it allows business to make strategic decisions. Since PAEA, rates have generally changed (with the exception of the exigent increase) by predictable amounts (and according to publicly available data) at regular intervals. This has helped mail maintain its value as a business communication tool even as digital media has become ubiquitous. Rate stability and predictability are bedrock requirements for business to stay with mail.

AF&PA believes the CPI-based price cap provides the Postal Service with the best opportunity to achieve sustained financial viability. Under this system, the Postal Service is no longer able to react to declining revenues simply by raising rates. Instead, it is required to focus on improving its business model by cutting costs and increasing efficiency. PAEA allows the Postal Service reasonable price flexibility, providing opportunities to bring forward unused pricing authority under the cap, pricing differentials, workshare discounts, and a provision for price adjustments due to unforeseen unusual events (exigent circumstances). The inflation-based price cap is the lynchpin of the ratemaking system that provides the checks and balances necessary for mailers to reasonably predict their costs, while providing accountability for the Postal Service with the incentive to control costs and improve efficiency.

AF&PA believes that the current system should continue with the CPI-based rate cap in place. Retaining the CPI cap is essential to enable mail to remain a cost competitive option for business communications. The CPI cap has been an effective mechanism in driving efficiency and has encouraged the Postal Service to cut costs to achieve greater financial stability without jeopardizing long-term demand, and thus the continued viability, of Postal Service mail products. The current system of regulation and the CPI-based cap create the correct incentives to maximize efficient service and ratepayer value. Raising the CPI price cap would remove these important incentives, resulting in a less efficient Postal Service with lower quality service, substantially harming mailers reliant on Postal Service market-dominate products. This in turn would reduce the demand for Postal Service market-dominant products as substitutes become more attractive.

B. USPS Financial Health

When PAEA was crafted, Congress anticipated that a CPI-based price cap would enable the Postal Service to achieve sufficient revenues to cover its operating costs and statutory obligations, as well as allow the Postal Service to generate retained earnings to support long-term financial health. An extended period of low levels of inflation, coupled with pressure from other marketing and communication channels, and the impact of the Great Recession, have all combined in ways that Congress did not anticipate, resulting in substantially negative impacts on Postal Service volumes and revenues. However, total USPS costs did not begin to diverge dramatically from the relatively stable historical trend until the imposition of the retiree health benefit ("RHB") prefunding requirement that was built into PAEA by Congress. We would submit that the financial instability of the Postal Service is not "due to" a deficiency of the rate setting system that the PRC needs to "fix", but the perilous financial condition of USPS is primarily due to a mandate by Congress that is responsible for approximately 90% of USPS accumulated net losses over the last ten years.

External pressures due to product substitution, increased competition, and changing customer demands are not unique to the Postal Service, and mirror the challenges faced by the paper industry. While the Postal Service was, like the entire economy, severely impacted by the Great Recession, it has since rebounded and has been operating profitability for the last several years. For instance, in the first quarter of Fiscal Year 2017, the Postal Service reported $522 million in controllable income.[1] This positive outcome is just the latest iteration of a developing trend; the Postal Service has achieved a total operating profit of $3.7 billion since the start of Fiscal Year 2014.[2] The net losses the Postal Service has experienced result from

[1] USPS Press Release, "U.S. Postal Service Reports Fiscal Year 2017 First Quarter Results" (Feb. 9, 2017).

[2] Fredric V. Rolando letter to the editor of USA Today (March 7, 2017) (available at (http://www.usatoday.com/story/opinion/2017/03/07/things-bad-postal-service-say/98871900/ (site visited Mar. 15, 2017); *see also* United States Postal Service FY 2016 Annual Report to Congress, Docket No. ACR2016, Library Reference USPS-FY 16-17 2016 Annual Report and Comprehensive Statement of Postal Operations at 15 (displaying positive controllable income every year from FY2014 through FY2016 and a target for positive controllable income in FY2017).

Congressionally-imposed mandates that bear little relation to the true revenue needs of the Postal Service.

While the PRC has proposed to maintain a price cap system, the multiple layers of additional price authority given to the Postal Service under the proposed regulatory system will likely result in a further customer exodus from mail, accelerating the volume loss that is responsible for 70% of USPS revenue. The loss of mail volume due to the PRC proposed rate increases is supported by a recent survey of mailers. The survey revealed that, as the rate increase rises, so does the percentage of mailers that expect to reduce mail volumes, with the average decline in mail volume 4.3 percent in relation to the highest proposed increase.[3] For mailers, the "cap" is maintained in name only, and does not reflect the equitable checks and balances intended by Congress. We can only guess that the PRC calculus in proposing the additional rate authority is based on the potential to cover total USPS financial obligations, along with the historical assumption that demand for mail is relatively inelastic in response to price changes. We believe the PRC focus should be USPS financial health based on revenues needed to support ongoing operations, coupled with incentives to continue to reduce costs and become more efficient. The underlying deficit on the USPS balance sheet due to the RHB prefunding requirements should be up to Congress to solve. Moreover, the theory that mail volume does not move substantially in response to rate increases is flawed. Mailers viewed the exigent rate increases as temporary, and not a permanent increase, and reacted accordingly, with the longer term in mind. In addition, historical price/volume models used by the Postal Service are based on

[3] EMA Foundation for Paper-Based Communications, Infotrends Mailer Organization Research Survey, 2018

small, or incremental price changes. Using historical model assumptions to predict the magnitude of change not previously experienced may be inappropriate, and just plain wrong.

AF&PA disagrees with the PRC proposal of additional rate authority of 1 percent as the mechanism to provide incentive for the Postal Service to increase operational efficiency and improve service. We don't think mailers should pay a penalty for USPS cost control efforts. We don't know a business model where the reward for controlling costs and becoming more efficient translates into the ability to charge customers more for the product or service.

With regard to noncompensatory products, or those for which attributable costs exceeds revenue, we agree that the system should address the related financial consequences of these products. A number of these products (magazines, catalogs, local newspapers for example) attract customers to the mail box, as well as drive additional business transactions that are delivered through the mail system. We would therefore suggest caution in the approach to "catch up" the cost coverage of these products so that rate increases are so high as to push mailers to other alternatives. As part of the solution, we would also expect the Postal Service to more closely examine opportunities to reduce its costs associated with delivering these products, and to accurately proportion its cost allocation to these products to ensure that current cost estimates are not overstated.

C. Service

Consistent and reliable delivery service is imperative for mailers. When predictability and reliability is diminished customer complaints rise, subscriptions face risk of cancellation, and advertisers consider alternative media. The Postal Service must find a way to maintain or improve reliable delivery service to maintain a viable market for its products. When it comes to meeting service metrics, our industry has clearly learned that we must look externally to understand the changing service needs of our customers and not focus on internal measurements of success. We agree that the PRC Annual Compliance Determination is an effective vehicle to measure whether or not service standards are being met. Changing the standards, or moving the goal posts of service should be evaluated based on meeting customer expectations as the first priority. AF&PA believes setting new standards, holding the Postal Service accountable, and establishing the execution plan to achieve service standard results should be a shared responsibility of the PRC and the Postal Board of Governors. Filling vacant Board of Governors positions should be a high priority supported by the PRC.

IV. Conclusion

AF&PA members depend heavily on the Postal Service to ensure their products and messages are delivered to their destination in a secure, timely and cost effective manner. Retaining the CPI-based cap as created by PAEA is essential to enable mail as a cost competitive option for business communications. The current system provides rate stability and predictability, which are required for businesses to stay with mail.

While the rate making system created by PAEA works well in meeting some of the objectives established by lawmakers more than ten years ago, it is not perfect, and is subject to improvement. With the exception of the onerous RHB prefunding requirement, the CPI-based rate cap system has been an effective tool to balance the business management levers of both the mailers and the Postal Service. The CPI-based cap may need some adjustment, but the ranges of adjustment the PRC proposes put future mail volumes at risk and may have the exact opposite effect of creating financial stability of the Postal Service. The multiple layers of increases as proposed get us closer to the pre-PAEA era of a cost-of-service model for setting rates, which may meet the needs of the Postal Service, but not for the rate payers who must foot the bill.

The Postal Service is a vast and complicated enterprise whose financial challenges cannot be solved through pricing alone. It will take an integrated approach that sets future rates that are just and reasonable, along with cost and efficiency goals aligned with the changing demand for mail. The PRC, mailers, Postal Service management, postal supply chain partners, and Congress all have a vested interest in the future success of USPS and have a role to play in working together to find a solution that is fair and equitable across multiple mail stakeholders.

We believe a future framework of reasonable rates based on the ongoing operational needs of the Postal Service, coupled with a stronger focus on increasing efficiency and improving service, will enable the Postal Service to realize success under the current system and meet the needs of the mailing industry, including the paper products companies that supply the raw materials for print communications and packages carried in the mail.

Weakening the CPI-based price cap would disturb the balance of meeting the objectives of PAEA "applied in conjunction with" each other, eliminate incentives to increase efficiency and improve service, and jeopardizes the financial viability of the Postal Service. AF&PA urges the Commission to reconsider its proposed solution for the U.S. Postal Service's financial challenges as the imposition of postal rates much higher than the rate of inflation will likely further imperil the financial position of the Postal Service by driving away the most valuable and profitable segments of mail. The Commission should direct the Postal Service to focus on improving the reliability of its service, reducing costs, and finding innovative sources of revenue.

Respectfully submitted,

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